
August 26, 2005



Oversight Review

Quality Control Review of Air Force Audit
Agency's Special Access Program Audits
(Report No. D-2005-6-009)

Department of Defense
Office of the Inspector General

Quality

Integrity

Accountability

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Acronyms

| | |
|------|---|
| AFAA | Air Force Audit Agency |
| AIC | Auditor-In-Charge |
| GAS | Government Auditing Standards |
| NAS | Naval Audit Service |
| PCIE | President's Council on Integrity and Efficiency |
| SAP | Special Access Program |



INSPECTOR GENERAL
DEPARTMENT OF DEFENSE
400 ARMY NAVY DRIVE
ARLINGTON, VIRGINIA 22202-4704

AUG 26 2005

MEMORANDUM FOR AUDITOR GENERAL, DEPARTMENT OF THE AIR FORCE

SUBJECT: Quality Control Review of Air Force Audit Agency's Special Access
Program Audits (Report No. D-2005-6-009)

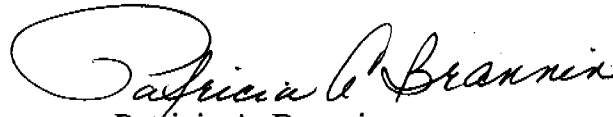
We are providing this report for your information and use. We reviewed the Air Force Audit Agency (AFAA) system of quality control for Special Access Program (SAP) audits for the three years ended September 30, 2004. The Government Auditing Standards (GAS) require that an audit organization performing audits and/or attestation engagements in accordance with GAS should have an appropriate internal quality control system in place and undergo an external peer review at least once every 3 years by reviewers independent of the audit organization being reviewed. As the organization that has audit policy and oversight responsibilities for audits in the Department of Defense, we conducted this external peer review of the AFAA SAP audits in conjunction with the Naval Audit Service's external peer review of AFAA non-SAP audits.

An audit organization's quality control policies and procedures should be appropriately comprehensive and suitably designed to provide reasonable assurance of meeting the objectives of quality control. We tested the AFAA system of quality control to the extent considered appropriate.

In our opinion, the system of quality control for the audit function of the AFAA SAP audits in effect for the period ended September 30, 2004, was designed in accordance with quality standards established by GAS. Further, the internal quality control system was operating effectively to provide reasonable assurance that SAP audit personnel were following established policies, procedures, and applicable auditing standards. Accordingly, we are issuing an unqualified opinion on your SAP audit quality control system for the review period ended September 30, 2004.

Appendix B contains comments, observations, and recommendations where AFAA can improve its quality control program related to SAP audits, as well as our responses to AFAA management comments to the draft report. Appendix C provides the full text of management comments in response to the draft report.

See Appendix A for the scope and methodology of the review. We wish to express our thanks to you and your staff for your cooperation and professionalism. Please contact Mr. Robert L. Kienitz, Acting Project Manager, at (703) 604-8754 or Ms. Carolyn R. Davis, Deputy Assistant Inspector General for Audit Policy and Oversight at (703) 604-8877 if you have any questions.

A handwritten signature in black ink, reading "Patricia A. Brannin". The signature is fluid and cursive, with a large initial "P" and "B".

Patricia A. Brannin
Assistant Inspector General
Audit Policy and Oversight

Cc: Director, DoD Special Access Program Coordination Office

Appendix A. Scope and Methodology

We limited our review to the adequacy of AFAA SAP auditors' compliance with quality policies, procedures, and standards. We judgmentally selected 3 SAP audits from a universe of 27 formal reports issued by AFAA SAP auditors in FYs 2002, 2003, and 2004, and tested each audit for compliance with the AFAA system of quality control. The Naval Audit Service conducted a review of the AFAA internal quality control system for non-SAP audits and/or attestation engagements and is issuing a separate report. The Assistant Inspector General for Audit Policy and Oversight will issue an overall opinion report on the AFAA internal quality control system that will include the combined results of the reviews of SAP and non-SAP audits.

In performing our review, we considered the requirements of quality control standards and other auditing standards contained in the 2003 Revision of the *Government Auditing Standards* (GAS) issued by the Comptroller General of the United States. GAS 3.52 states:

The external peer review should determine whether, during the period under review, the reviewed audit organization's internal quality control system was adequate and whether quality control policies and procedures were being complied with to provide the audit organization with reasonable assurance of conforming to applicable professional standards. Audit organizations should take remedial, corrective actions based on the results of the peer review.

We conducted this review in accordance with standards and guidelines established in the Draft 2004 President's Council on Integrity and Efficiency (PCIE) "Guide for Conducting External Peer Reviews of the Audit Operations of Offices of Inspector General." We modified the Guide to ensure consistency with the Naval Audit Service review of non-SAP audits, and to reflect the unique nature of auditing within a SAP environment. We interviewed AFAA auditors and their managers, reviewed AFAA internal audit-related policies and procedures. We performed this review in May 2005 at three AFAA field offices

We used the following criteria to select the audits under review:

- Worked backward starting with FY 2004 audits in order to review the most current quality assurance procedures in place.
- Eliminated Base Realignment and Closure audits because they are not considered typical audits.
- Avoided audits with multiple SAPs associated with the audit for ease of access.
- Avoided audits that have the same or similar titles to ensure review of multiple types of projects.

The following table identifies the specific reports reviewed.

| Report Number | Date | Title |
|-------------------|-------------|--|
| F2004-0004-FA0900 | 26 Jan 2004 | “Cash Controls” |
| F2004-0005-FA0900 | 4 Jun 2004 | “Financial and Contracting Management” |
| F2004-0007-FA0900 | 16 Jul 2004 | “Support Agreements” |

Limitations of Review. Our review would not necessarily disclose all weaknesses in the system of quality control or all instances of noncompliance with it because we based our review on selective tests. There are inherent limitations in considering the potential effectiveness of any quality control system. In performing most control procedures, departures can result from misunderstanding of instructions, mistakes of judgment, carelessness, or other human factors. Projecting any evaluation of a quality control system into the future is subject to the risk that one or more procedures may become inadequate because conditions may change or the degree of compliance with procedures may deteriorate.

Appendix B. Comments, Observations, and Recommendations

We are issuing an unqualified opinion because this is the first external peer review for AFAA SAP audits and the issues we identified were not cumulatively significant to the reports' findings, conclusions, and recommendations. Overall, we found that AFAA could improve the quality control system and guidance for SAP audits related to the areas of Independence, Audit Planning, Supervision, Evidence and Audit Documentation, Reporting, and Quality Assurance. Implementing the recommendations identified below would improve the quality control system and help maintain an unqualified opinion.

Independence. GAS 3.03 states that audit organizations and individual auditors “should be free both in fact and appearance from personal, external, and organizational impairments to independence.” AFAA Instruction (AFAAI) 65-103, “Audit Management and Administration,” requires auditors to sign an Independence Statement at the beginning of each audit to “certify there are no relationships and beliefs that might cause the auditor or supervisor to limit the extent of the inquiry, limit disclosure, or slant audit findings in any way.”

We found no indications of impairment during our review. However, there were no Independence Statements for two of the three audits. The third audit had an Independence Statement that had been backdated by the auditor, who used a version of the AFAA Independence Statement that was not in effect until April 2004, after the date of his signature – August 2003.

The AFAA Chief, Special Programs Division stated that he had been unaware of the requirement for project-specific Independence Statements until the fall of 2003. He relied on annual Financial Disclosure Statements and the AFAA Annual Certification acknowledging the need to report any conflicts of interest to verify the auditors' independence. However, AFAA had the project-specific Independence Standard in place since September 2002 and all three projects were initiated after this date. AFAA Policy, Oversight, and Systems Division personnel stated to us that new policy is placed on the AFAA intranet homepage, and disseminated in an e-mail to all AFAA personnel.

Audit Planning. GAS 7.02 states that “work is to be adequately planned,” and GAS 7.07 states that “planning should be documented.” GAS 7.41 requires auditors to document the planning, and states:

[T]he form and content of the written audit plan will vary among audits, but should include an audit program or project plan, a memorandum, or other appropriate documentation of key decisions about the audit objectives, scope, and methodology and of the auditors’ basis for those decisions. It should be updated, as necessary, to reflect any significant changes to the plan made during the audit.

AFAAI 65-101, “Internal Audit Procedures,” contains guidance on audit planning as well as a template “audit planning program” that all AFAA auditors are required to use during audits. AFAAI 65-101 states that audit managers should:

...continuously monitor auditor progress during the planning phase, provide assistance as needed, and assure the auditor conducts the planning phase in accordance with AFAA policies and procedures; and ensure the auditor uses the Audit Planning Program and either completes each step or provides rationale for not completing the step.

We found insufficient documentation related to audit planning in all three AFAA SAP audits we reviewed. For example, one of the audits did not have an audit program and another did not have supervisory approval for audit steps that were either not completed during the audit or were marked “N/A.”

Supervision. GAS 7.45 requires staff to be properly supervised and GAS 7.47 states that supervisory reviews of audit work should be documented. AFAAI 65-103 requires supervisors to use an “Audit Review Record” to document the supervision and supervisory reviews. According to AFAAI 65-103, the review record must include the supervisor’s initials and date, and the working papers must contain “clear evidence” of supervisory review. We found that several working papers in each of the audits were either not reviewed in a timely manner or not reviewed at all by a supervisor. The AFAA Chief, Special Programs Division stated that since the office locations are widely scattered across the U.S., he visits each office only three to four times per year. In two audits, this prevented him from being able to review the working papers until five months after they were written. This is mitigated somewhat by the fact that all of the auditors at the AFAA SAP field offices are senior auditors.

We recognize that the SAP audit environment presents challenges for complying with some of the AFAA quality processes. However, supervision is a key government auditing standard and a key element of an effective quality program. Supervisors must find ways to provide proper supervision even within such an environment.

Evidence and Audit Documentation. Working papers are used to organize, prepare, and collect relevant evidence and documentation during an audit. GAS 7.66 requires that auditors prepare and maintain audit documentation, and that the audit documentation should contain support for findings, conclusions, and recommendations before auditors issue their report. GAS 7.68 states that the audit documentation forms the principal support for the auditors' report.

AFAAI 65-103 requires auditors to document the work performed to support significant conclusions and judgments, including descriptions of transactions and records examined that would enable an experienced auditor to examine the same transactions and records. AFAAI 65-103 provides the following guidelines for working papers (excerpt): "The working papers should be understandable without supplementary oral explanations. Anyone using or reviewing the working papers should be able to readily determine their purpose and source, the nature and scope of the work performed, and the auditor's conclusions."

Although we found AFAA SAP audit working papers contained sufficient, competent, and relevant evidence to support judgments and conclusions in the reports, improvements could be made to audit documentation. We found that 6 of the 15 judgmentally selected facts and figures we reviewed in one report, 10 of 15 in another report, and 1 of 15 in the third report could have been better supported. Some of the deficiencies we noted during our review were:

- Source documents were missing information about the provider of the source documents, and in some cases it was impossible to determine whether a document was auditor-generated or a source document.
- Several figures in the report had no audit trail to source documents. We eventually identified the source documents and verified the data based on our review of source documents.
- A figure in the report referenced back to a note written by the auditor that did not include any source information. During our review, the auditor attributed the statement to management, but there was no attribution on the note or in the report. With such attribution a reviewer of the working papers or of the report can not know if the management that provided the information was a reliable source.
- Working papers, such as background information and briefing charts, were missing the AFAA-required elements of purpose, source, and conclusion.

Reporting. GAS 8.45 states that “... evidence included in audit reports should demonstrate the correctness and reasonableness of the matters reported...” GAS provides a best practice to help ensure this standard:

One way to help ensure the audit report is accurate is to use a quality control process such as referencing... in which an experienced auditor who is independent of the audit verifies that statements of fact, figures, and dates are correctly reported, that findings are adequately supported by the audit documentation, and that the conclusions and recommendations flow logically from the support.

AFAAI 65-101 requires auditors to obtain an independent reference review (IRR) before the draft report is issued to management. The guidance requires the independent referencers to trace information in the cross-referenced draft report through the summary working papers to the supporting working papers to determine that they are consistent with and supported by the working papers and to “be alert to statements in the report which seem illogical or lack clarity, ensure the team chief has reviewed all supporting working papers and cleared any review notes, and refuse to sign the IRR record until the team chief has finished reviewing and signed off on the working papers.”

We found that the three AFAA SAP audit reports generally met the GAS reporting standards. However, none of the SAP reports we reviewed complied with the AFAA requirements for IRRs. None of the three reports received an IRR before the draft report was issued to management, and two of the three reports received no IRR. The AFAA Chief, Special Programs Division stated that he was unable to conduct IRRs before the draft reports were issued due to a lack of resources within the SAP environment, and that he relied on the experience of the auditors to ensure the quality of the audits.

We found that the one completed IRR was not adequately documented; specifically, the referencer’s signature on the IRR document was not dated so we were not able to ascertain whether the IRR was completed before the draft report was issued. Also, the referencer did not indicate any concerns during the IRR; however, we found discrepancies with the references, such as a figure cited in the report as representing fourth quarter data that was documented in the working papers as representing the first, second, and third quarters only.

We found misleading or unsupported information in the final reports of the two audits that did not have IRRs. Although none of these inaccuracies affected the overall conclusions of the reports, they demonstrate instances that an IRR might have alerted the auditors to before the reports were issued to management. Specifically, we found:

- A figure cited in the report as “a contract was established in April 2000 for \$421.0 million”; however, \$421.0 million was the amount of the contract after several contract modifications; the amount of the contract at the date of establishment was \$402.0 million.

- A figure cited in the report as \$330,000 was documented in the working papers as \$300,000.
- A figure cited in the report as 52 percent was documented in the working papers as 53 percent.

Over time if errors continue to be found in reports, the report recipients may begin to question significant conclusions of the reports. AFAAI 65-101 does not exclude the IRR from the SAP audits and does not define circumstances in which an IRR need not be done.

Quality Assurance. GAS 3.50 requires that an audit organization's internal quality control system should include procedures for monitoring, on an ongoing basis, whether the policies and procedures related to the standards are suitably designed and are being effectively applied. This is often referred to as an internal quality assurance program.

AFAAI 65-105, "Internal Quality Control Review Program," provides guidance on the AFAA internal quality control program, and notes that it consists of four components: supervision, independent referencing, internal quality control reviews, and external quality control reviews. AFAA conducts three types of internal reviews: functional, management, and quality assurance. Quality assurance reviews evaluate whether AFAA activities adhere to applicable government auditing standards and internal policies and procedures for conducting audit projects. The AFAA internal quality control review program uses a team approach to accomplish this type review and a checklist based on GAS and AFAA policies and procedures. The AFAA Policy, Oversight, and Systems Division develops an annual review plan that describes the functional, management, and quality assurance reviews planned for the next year. The AFAA Policy, Oversight, and Systems Division also prepares a 3-year review plan for quality assurance reviews which ensures each AFAA audit division/region receives a quality assurance review at least once during the 3-year cycle.

AFAAI 65-105 does not exempt or waive SAP audits. However, AFAA personnel involved with the internal quality control review program stated that they do not conduct quality assurance reviews of SAP audits. AFAA has not conducted a quality assurance review of a SAP audit in at least 10 years, specifically due to the limitations on access because of security requirements.

Conclusion. SAP audits seldom get the monitoring or oversight of non-SAP audits because of the security requirements. AFAA guidance on the quality control system does not specifically address SAP audits. The AFAA Chief, Special Program Division has stated that he is unable to fully implement key elements of the AFAA quality control

system because of security-related limitations. We recognize the challenges that result from these limitations; however, AFAA needs to re-emphasize the importance of complying with the key elements of the quality control system.

Although we did not find that any of the deficiencies we noted would individually or collectively justify an opinion other than unqualified, AFAA needs to ensure on an ongoing basis that their internal quality control system within the SAP environment taken as a whole still provides reasonable assurance that GAS is met.

Recommendations. We recommend that the Air Force Auditor General:

1. Stress to SAP auditors the importance of complying with existing guidance and procedures related to independence, specifically in completing independence statements.

Management Comments. The AFAA concurred in principle with the recommendation and stated that while they agree improvements were needed to document their independence on each project, the AFAA does not believe recommending a specific software package was inappropriate. The AFAA stated that the audit evaluated various processes used at several locations and recommended streamlining and improving the entire operation. At the Command-level, the newly developed software package allowed the auditor to easily reconcile total cash accountability. However, reconciliation was difficult and labor intensive at subordinate units because the tracking systems were not as effective. As a result, the AFAA report stated that the units used different procedures and recommended the Command direct use of the Command-level software package. While working paper documentation could have been better, the AFAA stated that they complied with GAS 3.14 and had sufficient evidence to justify recommending the Command-level system. The Special Programs Division Chief will issue a memorandum by September 30, 2005, to all SAP auditors stressing the importance of complying with guidance related to independence, including preparing independence statements and providing advice to management.

Reviewer Response. Management comments meet the intent of the recommendation. We revised the report including this recommendation based on comments to the draft report related to circumstances in which the auditor provided advice to the command. No further comments are required.

2. Ensure that the SAP auditors and supervisors are timely made aware of changes in policies, practices and guidance.

Management Comments. The AFAA concurred with the recommendation and stated that the Special Programs Division Chief will issue a memorandum by September 30, 2005, directing all SAP auditors to periodically review the AFAA web site to identify changes in policies, practices, and guidance.

Reviewer Response. Management comments are responsive.

3. Re-emphasize to SAP auditors and supervisors the importance of complying with the key elements of the AFAA quality control system, specifically related to audit planning, supervisory reviews, and independent reference reviews.

Management Comments. The AFAA concurred with the recommendation and stated that for audit planning the Special Programs Division Chief will issue a memorandum by September 30, 2005, to all SAP auditors emphasizing the importance of complying with planning guidance contained in AFAAI 65-101. Regarding supervision, the AFAA stated that the Special Programs Division Chief will make working paper reviews a higher priority and will delegate supervisory responsibilities to a GS-14 for some projects. In addition, the Division Chief will issue a memorandum by September 30, 2005, to all SAP auditors directing them to submit periodic project status reports and document project related telephone conversations with the Division Chief. For independent referencing, although very important, the AFAA stated that performing independent referencing on every Special Programs Division project may not be practical for reasons such as security considerations and most locations have only one auditor and temporary duty travel may not be cost-effective. However, the AFAA will revise guidance by September 30, 2005, to give the Division Chief the flexibility to decide which projects warrant independent referencing depending on project complexity, working paper location, and security classification. If the Division Chief decides independent referencing is not warranted, a memorandum for record supporting the decision will be required. Also, independent referencing on all projects at locations with more than one auditor will be required.

Reviewer Response. Management comments meet the intent of recommendation.

4. Establish as part of its internal quality control review program, internal quality assurance reviews of selected SAP audits in order to comply with GAS 3.50.

Management Comments. The AFAA concurred in principle with the intent of the recommendation and stated while they agree including SAP audits in quality assurance reviews would add quality control, potential benefits must be weighed against security implications. As an alternative, the Division Chief will have senior personnel perform complete reviews of selected projects using AFAA quality assurance review checklists and report results to the Division Chief and Auditor General.

Reviewer Response. Management comments meet the intent of recommendation. We recognize that the SAP audits could not necessarily be treated the same as non-SAP audits in the internal quality assurance program. The AFAA alternative procedures meet the intent of GAS for on-going monitoring.

Appendix C. Management Comments



DEPARTMENT OF THE AIR FORCE
AIR FORCE AUDIT AGENCY

9 August 2005

MEMORANDUM FOR ASSISTANT INSPECTOR GENERAL, AUDIT POLICY AND
OVERSIGHT
ATTN: MS. PATRICIA BRANNIN

FROM: HQ AFAA/DO
1126 Air Force Pentagon
Washington DC 20330-1126

SUBJECT: Response to 20 July 2005 Draft Report, Quality Control Review of the Air Force
Audit Agency's Special Access Program Audits

My staff and I reviewed the subject draft review and are pleased you concluded our quality control system meets standards established by the President's Council on Integrity and Efficiency and provides reasonable assurance Air Force Audit Agency personnel are complying with professional auditing standards when conducting work in special access programs. We concur with the review results and recommendations and provide the attached responses.

We express our thanks to your staff who conducted this review in a professional and effective manner. Should you have questions, please call me at (703) 696-7764 or have your staff contact Mr. Jim Sommer at (703) 696-7727 or Mr. Andy Giancola at (703) 602-0172.

A handwritten signature in black ink, reading "Michael V. Barbino".

MICHAEL V. BARBINO
Assistant Deputy Auditor General

Attachment:
Recommendation Responses

Revised at
pg. 11

Revised
Report at
pg. 6

RESPONSES TO RECOMMENDATIONS IN
20 JULY 2005 DRAFT REPORT, QUALITY CONTROL REVIEW
AIR FORCE AUDIT AGENCY'S SPECIAL ACCESS PROGRAM AUDITS

1. Recommendations. The Air Force Auditor General should:

a. Recommendation 1. Stress to Special Access Program (SAP) auditors the importance of complying with existing guidance and procedures related to independence, specifically in completing the independence statements and ensuring that they make clear to management their role when providing advice.

b. Recommendation 2. Ensure that the SAP auditors and supervisors are timely made aware of changes in policies, practices, and guidance.

c. Recommendation 3. Reemphasize to SAP auditors and supervisors the importance of complying with the key elements of the AFAA quality control system, specifically related to audit planning, supervisory reviews, and independence reviews.

d. Recommendation 4. Establish as part of its internal quality control review program, internal quality assurance reviews of selected SAP audits in order to comply with GAS 3.50.

2. AFAA Comments. We concur with the observations and recommendations and provide the following comments:

a. Recommendation 1. Concur in principle.

(1) We agree improvements are needed to document our independence on each project, but do not believe recommending a specific software package was inappropriate. The audit evaluated various processes used at several locations and recommended streamlining and improving the entire operation. The "software packages" cited were locally developed Access database applications at two units and an Excel spreadsheet application at the third unit. At Command-level, the newly developed Access system allowed the auditor to easily reconcile total cash accountability. However, reconciliation was difficult and labor-intensive at subordinate units because tracking systems were not as effective. Therefore, our report stated the three units used different procedures and recommended the Command direct use of the Command Access database. The Command concurred and has used the system successfully for two years. While working paper documentation could have been better, we complied with GAS 3.14 and had sufficient evidence to justify recommending the Command system.

(2) The Special Programs Division Chief will issue a memorandum to all SAP auditors stressing the importance of complying with guidance related to independence, including preparing independence statements and providing advice to management. Estimated Completion Date: 30 September 2005.

b. Recommendation 2. Concur. The Special Programs Division Chief will issue a memorandum directing all SAP auditors to periodically review the AFAA web site to identify changes in policies, practices, and guidance. Estimated completion date: 30 September 2005.

c. Recommendation 3. Concur. The Special Programs Division has several unique challenges in these areas.

(1) Planning. The Special Programs Division Chief will issue a memorandum to all SAP auditors emphasizing the importance of complying with planning guidance contained in AFAAI 65-101. Estimated Completion Date: 30 September 2005.

(2) Supervision. The Special Programs Division Chief directly supervises eight auditors assigned to six locations with limited electronic communication capability for security reasons. This situation makes it very difficult to review working papers more than once a quarter in most instances. As the report mentions, this condition is mitigated because the Division has experienced auditors. The Division Chief will make working paper reviews a higher priority and will delegate supervisory responsibilities to a GS-14 for some projects. Further, the Division Chief will issue a memorandum to all SAP auditors directing them to submit periodic project status reports and document frequent project-related telephone conversations with the Division Chief. Estimated Completion Date: 30 September 2005.

(3) Independent Referencing. Although very important, performing independent referencing on every Special Programs Division project may not be practical for reasons such as: (a) most locations only have one auditor and frequent temporary duty travel may not be cost-effective; (b) mailing working papers to another location is not a viable option for security reasons; and (c) increased auditor access to sensitive programs is not prudent. Nevertheless, we recognize the need for action and will revise Agency guidance to give the Division Chief the flexibility to decide which projects warrant independent referencing depending on project complexity, working paper location, security classification, etc. If the Division Chief decides independent referencing is not warranted, we will require a memorandum for record supporting this decision. Further, we will require independent referencing on all projects at locations with more than one auditor. Estimated Completion Date: 30 September 2005.

d. Recommendation 4. Concur in principle. While we agree including SAP audits in quality assurance reviews would add quality control, potential benefits must be weighed against security implications. DoD Directive 0-5205.7 states the number of persons granted access to a SAP should be strictly limited to the minimum necessary to execute the program, and to those who will clearly and materially contribute to the program. Further, the directive states DoD Components assigned oversight duties should perform these functions using small cadres of appropriately cleared and accessed personnel whose primary responsibility is to support SAPs. Deviating from this policy to grant more individuals SAP access increases the security risk. As an alternative, the Division Chief will periodically have senior AGS personnel perform complete reviews of selected projects using AFAA quality assurance review checklists and report results to the Division Chief and Auditor General. This new control, combined with increased Division Chief oversight, selective independent referencing, and peer reviews, will provide assurance we comply with government auditing standards. Estimated Completion Date: 30 September 2005